

DOCUMENT RESUME

ED 305 047

IR 013 723

AUTHOR Rosen, David
TITLE The Tail That Wags the Dog: The Impact of Homevideo on the Entertainment Business.
PUB DATE Oct 88
NOTE 10p.; Paper presented at the Telecommunications Policy Research Conference (16th, Airlie House, Warrenton, VA, October 30-November 1, 1988). For other papers of this conference, see IR 013 715-735.
PUB TYPE Information Analyses (070) -- Viewpoints (120) -- Speeches/Conference Papers (150)
EDRS PRICE MF01/PC01 Plus Postage.
DESCRIPTORS Broadcast Industry; Cable Television; Commercial Television; Film Industry; *Films; *Marketing; *Public Policy; *Retailing; *Videotape Recordings

ABSTRACT

Homevideo is the most important innovation to enter the entertainment industry since the mass adoption of television nearly 40 years ago. It has revolutionized the movie studios, contributed to the crisis besetting the broadcast television networks, and changed the way Americans are entertained. Homevideo is the only private-sector mass rental business, and has very quickly matured into a sophisticated industry. However, homevideo may be vulnerable to cannibalization by more efficient, convenient, and competitively priced delivery mechanisms because of its principal role as a resale market for feature films. Thus, homevideo may be ultimately replaced by the wider scale adoption of such alternative delivery mechanisms as pay-per-view or direct-to-home satellite services. (EW)

* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *

ED305047



U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION
CENTER (ERIC)

☒ This document has been reproduced as
received from the person or organization
originating it.
☐ Minor changes have been made to improve
reproduction quality.

• Points of view or opinions stated in this docu-
ment do not necessarily represent official
OERI position or policy.

THE TAIL THAT WAGS THE DOG:
THE IMPACT OF HOMEVIDEO ON THE ENTERTAINMENT BUSINESS

Prepared for
NATIONAL TELECOMMUNICATIONS RESEARCH COUNCIL
16TH ANNUAL TELECOMMUNICATIONS POLICY RESEARCH CONFERENCE
October 30-November 1, 1988

Prepared By
DAVID ROSEN
LINK Resources Corporation
79 Fifth Avenue
New York, N.Y. 10003
212-627-1500
October 1988

LINK Resources Corporation

"PERMISSION TO REPRODUCE THIS
MATERIAL HAS BEEN GRANTED BY
Gerald R. Faulhaber

TO THE EDUCATIONAL RESOURCES
INFORMATION CENTER (ERIC)."

IR013723

The Tail That Wags the Dog:
The Impact of Homevideo on the Entertainment Business

Introduction

Good morning. My discussion will focus on the homevideo business and its impact on the changing structure of the entertainment industry.

My thesis is quite simple: Homevideo is the most important innovation to enter the entertainment industry since the mass adoption of television close 40 years ago. It has revolutionized the movie studios, contributed to the crisis besetting the broadcast television networks and changed the way Americans are entertained.

Nevertheless, homevideo is the most vulnerable "new media" because it -- as opposed to, say, cable television -- has failed to create truly original programming with mass consumer appeal.

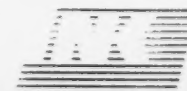
Because it is "merely" a resell market for successful theatrically-released movies, homevideo can -- and ultimately will -- be effectively superceded by the wide-scale adoption of an affordable and efficient alternative delivery mechanism like pay-per-view or direct-to-home satellite services.

Homevideo Status

Homevideo has had and continues to have a fundamental effect on entertainment. It has:

- * Profoundly transformed the TV -- and I dare say, the movie theatre -- viewing experience by stimulating what I would call "movie literacy" among a growing audience of college-educated and more sophisticated movie goers as well as casual viewers and younger people.
- * Transformed entertainment retailing through the establishment of a novel distribution channel of local outlets for the rental and/or purchase of prerecorded cassettes.
- * Changed the motion picture business by providing a major new revenue stream and, thus, changed the movie release sequence or "windows".
- * And, changed the broadcast and cable television in terms of time-shifting/off-air-recording and fed TV viewing erosion by providing alternative prerecorded product.

Today, homevideo is ubiquitous. Some basic bench-mark statistics will demonstrate its importance:



- * About 6 out of every 10 households have at least one VCR, and more and more homes -- we estimate about 20 percent -- own two or more VCRs.
- * There are about 65,000 homevideo titles in circulation, including your favorite movie and television show as well as specialized music, sports, training, cooking, self-help and religious tapes -- nearly any tape that you could ever want!
- * There are an estimated 55,000 retail outlets throughout the country for either the rental or purchase of prerecorded tapes.
- * And the PRC market will generate an estimated \$8 billion in total retail dollars this year -- about double total movie box office grosses (yet only about one-third of total TV advertising dollars).

This snap shot is intended to help locate the VCR in its current context. It is a vantage point from which to look back on how an industry -- or, more correctly, a social phenomenon -- took root in the U.S. as well as to project some likely future scenarios so that we can fully grasp its impact on the structure of the entertainment business.

Ironies of History

On Saturday, October 29th, MCA released ET: The Extra-Terrestrial into the homevideo market. As such, it is one of the most important dates in the history of homevideo business and will be long remembered as the high-water mark or zenith of homevideo.

ET's release is of such importance for the following reasons:

- * First and foremost, Steven Spielberg's ET is the most popular movie ever made -- grossing an estimated \$700 million in its worldwide theatrical release.
- * MCA will attempt to deliver 12 million cassettes to meet the unparalleled pre-sale consumer enthusiasm -- this is two-and-one-times more cassettes than Disney's Cinderella or twelve-times the number of copies of Jane Fonda's Workout sold to date.
- * The cassette is targeted for the growing sell-through market and will be offered at a suggested retail price of \$24.95.
- * Additionally, Pepsi is providing a \$5.00 rebate which will discount the tape to \$19.95 -- and Pepsi is supporting a heavy television and print marketing campaign.

All this adds up to an estimated gross retail sales and eventual rental revenues approaching \$1 billion and a return to MCA of an estimated \$200 million. This one release will propel MCA into the 1988 leading video company and make ET the all-time most popular video.



Ironically, almost twelve years ago -- in September 1976 -- MCA's president Sidney Sheinberg started a process which almost put an end to or retarded the introduction of the VCR. Sitting in his Burbank office, Sheinberg saw a Sony promotional announcement championing its new VCR Betamax and its ability to copy shows off-the-air. His fear that this new technology would violate copyright protections led him to initiate -- with Disney -- a long drawn-out legal challenge to time-shifting that eventually ended up in a landmark Supreme Court decision affirming the right of off-air copying.

This legal challenge occurred at a propitious moment in the VCR's adoption history. In '76, Beta-VCR penetration stood at less than 100,000 households. Similarly, the first prerecorded cassettes were adult/pornographic, select sports and a few popular movies, and they were selling for between \$50-\$200 each. The studios supported this sell-through market -- going so far as to issuing contracts explicitly prohibiting rentals.

But in the midst of confusion over VCR legal challenges and a slow increase in available PRCs, a rental business sprang up! And it did so quite anarchically -- without form or structure. Protected by the first-sale doctrine, an assortment of, first, tens, then thousands, and, finally, tens-of-thousands small entrepreneurs took shape across the country forming a web of "mom-and-pop" specialty video outlets. And Americans from all walks of life responded vigorously to this new entertainment option initially renting almost anything put on the shelf.

It's important to keep in mind that homevideo is the only private-sector mass rental business. Except for public library free-circulations, all books, magazines and records are cash-and-carry products paid for directly out of the consumer's pocket. This anomaly is a result of the basic relationship of movie studios to movie theatres -- which "rent" the right to screen a movie as opposed to buying it -- transferred to mass retail. From a studio perspective, it's a transfer that has not truly worked to its advantage -- and I'll get into this in more detail shortly.

The Homevideo Market Matures

In 1979 the FCC undertook a major study of the homevideo industry. One of its key findings was:

By the end of 1976, 1.2 million (1.5%) of U.S. homes will have a VCR. By 1984, 5.5 to 6.8 million (6.2-7.7% of homes) VCRs are projected to be in use. VCR sales are then expected to level off at 1.0 million units a year. Total owners are expected to eventually be 10-14% of U.S. TV households.

In light of hindsight, we can see how wrong -- or perhaps, as the voice of the broadcasting industry, self-serving? -- this assessment was. During the 1976-1986 period, the homevideo business grew from a



rough-and-tumble entrepreneurial business to a sophisticated industry. Its volatility was due to the rapid rate of VCR adoption. Among key indicators of this growth were:

- * Rapid VCR household penetration -- in 1980, VCR penetration stood at about 1.5 percent but by 1988 it had skyrocketed to nearly 60% of all TV households. (In consumer electronics, when a product crosses 30% penetration moves from a niche- to mass-market status.)
- * Rapid VCR price falls -- during this same period, average VCR retail prices fell from close to \$1,000 to \$383.

That's a remarkable growth experience. It could be best illustrated by comparing movie theatre admission and VCR purchases since 1975.

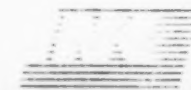
VCR Sales vs. Movie Attendance (in 000)		
Year	Movie Attendance	VCR Sales
1975	1,033	35
1980	1,022	900
1985	1,055	12,700
1987	1,089	12,900

Source: MPAA and LINK Resources

Movie theatre admissions have remained more or less constant since the mid-1970s, peaking in 1983-1984 -- and are likely to remain at about 1 million for the foreseeable future. Additionally, this was a period in which average ticket prices grew from \$2.03 to \$3.91 -- in inflationary dollars. This is a stunning indicator of American consumer preference.

In terms of homevideo, among the key indicators of industry maturation are:

- * The gradual consolidation of the major studios as video suppliers, with only a few "independents" (like Vestron) having secured a viable position.
- * A growing consolidation among rental outlets and the emergence of major (and highly efficient) chains and the entry of mass merchants into the process.
- * A shift from "pull through" to "push through" as more marketing and advertising dollars have to go into a homevideo release.
- * The attempt to shift the PRC market from rental to sell-through by encouraging the collection of video libraries.



These elements of homevideo restructuring are occurring at a time when the VCR industry is witnessing a slowdown of new unit sales (estimated at about 10 million this year -- down from the 13 million high of 1986) and the rise of multiple-VCR households. Making matters worse, the number of monthly rentals per VCR is also falling and, as the blush starts to fade from the novelty-rose, consumers find the "bait-and-switch" allure of their local video outlet too inconvenient and unpredictable to maintain loyalty.

Movies: Theatrical and Homevideo Release

In the entertainment industry, as a product begins to really take-off, technological innovation (its appeal to the early-adopter!) is replaced by programming availability and price as the principal drivers for adoption by later-adopters! Thus, as the market matured, the easy availability of popular titles continually drew in new devotees.

The homevideo market is driven by feature films, particularly the most popular movies -- the "A" and "Super-A" titles. These are movies that generate \$30 to \$100 million and over-\$100-million in box office grosses. In all, movies account for approximately 80-85% of prerecorded rental "turns" -- but about 65% of sell-through (not including ET, which will change the balance).

From a structural perspective, the impact of homevideo on the entertainment industry can be easily gleaned from the enormous increased revenue it has contributed to the movie studios coffers. Using Goldman Sachs data, it's useful to compare the relative financial contributions of theatrical and homevideo.

PRC vs. Theatrical Box Office Revenue (in %)

Year	Theatrical Revenue	PRC Revenue
1980	75%	1%
1984	51%	26%
1987	42%	38%

Source: Goldman Sachs

Even though homevideo performance has been enormously successful, it could have been far better. As I mentioned earlier, homevideo "rentals" are different than movie theatre "rentals". No first-sale problem intervenes between the studio and exhibitor; thus, rental rates can be flexible, calculated against theatre performance. With homevideo, the studio gets no money back from the number of "turns" a movie enjoys at a video outlet. Therefore, whereas in exhibition, the studio get approximately 50% of rentals; in homevideo, they get about one-third. Not bad, but not nearly as good as it could have been under a different system -- say, pay-per-view.



The impact of such significant homevideo performance can't be underestimated. Beyond simply revenue stream contribution, its impact can be seen in the following ways:

- * It has led to the demand for a considerable amount of new original programming to "fill the pipeline".
- * Which has, in turn, fueled the emergence of a viable independent film business that is separate and distinct from the studios (and of the "B" houses of old).
- * It has led to a restructuring of film financing -- no deal can be done anymore without pre-sale homevideo performance factored into the return forecast.

Finally, and I think of real importance -- especially in terms of those of us gathered here today -- is that it has contributed to the return of adults to movie going! (The convergence of the maturation of baby-boomers -- and their families -- and the rise of the VCR cannot be underestimated.) In turn, this has led to a qualitative improvement of the kind of movies the Hollywood studios are producing.

The Future

From an historical perspective, I believe, the release of ET into homevideo will be viewed as the high-watermark of the homevideo industry. This does not mean that the future is bleak or defined by no-growth. Quite the contrary. The appeal of homevideo is still strong and will continue to be so for many years to come. However, revenue growth rates will slacken as VCR sales slow, as PRC rental enthusiasm cools and as the industry becomes an increasingly hit-driven business.

Let me extend a little further with the ET analogy. While no one knows what the next ET will be, we can say that no other movie with the performance experience of ET is currently sitting in a studio vault. So to capture the same level of mass enthusiasm will require a new super-smash hit and the years necessary to nurture a market for the once-in-a-lifetime sell-through homevideo release.

As I indicated at the outset of this presentation, I believe that homevideo is vulnerable to cannabilization by more efficient, convenient and competitively priced delivery mechanism because of its principal role as a resell market for feature films. This will not come soon, nor all at once. I mentioned two current alternative delivery mechanisms that are vying for a piece of the PRC market -- pay-per-view and direct-to-home satellite. Another could be a telephone-company "video dialtone" concept as is being developed by GTE/Cerritos and Bell South/Heathrow. Others will emerge in the next decade.

From a structural perspective, the entertainment business as program originators are in the driver's seat. All media are merely distribution vehicles to bring a product to the consumer. The economics of financial



performance has historically dictated which is the premier "window" of first-release -- thus, the replacement of TV by pay cable and, in turn, pay cable by homevideo.

However, a deeper question must be asked: Is there something inherent to the movie theatre experience that makes it qualitatively different from the home-based video experience so as to safeguard its first-window exclusivity? Is the theatrical venue only a lever to open up all other markets?, or is it a social experience comparable to, say, a sporting event, where audience participation or attendance may require different terms of evaluation than purely economic return? This is an important line of questioning and requires more research.

Currently and for the foreseeable future, homevideo is the second "window" because it contributes to movie companies the second largest proportion of financial return. If, however, an impulse ordering system like pay-per-view, with efficient advertising and promotional support, could be harnessed it could possibly become the "first window" -- or, at least, replace homevideo as the second window. From a purely financial perspective, there is nothing sacrosanct about movie theatres requiring them to be maintained as the lead distribution outlet.

The name of the game in entertainment is programming. And why should program production, particularly feature film production, be limited to the studios? If the television networks were freed from current syndication restrictions (as they might well be after 1990) and could invest heavily into original program production (and get a lion's share of the syndication return), they could get more actively involved in the made-for-TV market and, potentially, in the theatrical market. Right now, ABC and NBC have small movie divisions aimed at a modest performance in the theatrical and homevideo markets and then supplying product for movies-of-the-week. Similarly, the vertically integrated cable system operators/programming networks could also enter the movie business; given TCI's control over the UA-theatre chain, it might even make good business sense.

Finally, the homevideo revolution -- combined with the strength of all ancillary markets -- could help fuel an era of foreign acquisition of Hollywood studios. We've seen the first with Murdoch's takeover of Fox. Rumors are circulating as to Sony's interest in Columbia and Philips's in MGM/UA. Companies that are not "protected" by a major conglomerate (like Paramount/Gulf & Western) or part of a very efficient and profitable media conglomerate (like MCA or Warner) are potential targets -- and could be sold if they suffered a sustained performance downturn.

Policy Implications

The rise of homevideo and cable television has introduced a new phenomenon into the home entertainment mix. Entertainment as well as information delivery to the home has come from two distinct sources: that which is available over a "network" like television or radio and



that acquired at a retail outlet like a book or record. Historically, the former was "free" due to advertiser supported while the latter was paid-for directly by the consumer (even though a good proportion of the direct costs for producing the product, as in the case of newspapers and magazines, was paid for by advertiser support).

This situation continues to define consumer access to entertainment product. But now we can see the contours of this arrangement beginning to change. First, audience viewing of "free" TV is eroding with the proliferation of alternative viewing options, particularly pay cable, pay-per-view and homevideo. Second, in gross dollars, consumers will pay about as much for cable basic/pay services, homevideo rentals/sales and movie tickets this year as TV (network, spot, local and cable) receives in advertising dollars. This is a critical indicator of an historic shift in program financing or subsidy sources.

The policy implications of this shift in financing may not seem clear at this point, but they will become more pronounced with time. One example will illustrate. The recent Tyson-Spinks heavy-weight fight was a major pay-per-view draw, grossing upwards of \$30 million. Homeviewers wishing to see the fight through ppv had to pay \$35. The important issue is whether either Tyson or Spinks as young men could have afforded to watch this fight? And how many other Black or other minority youth -- for whom Tyson and Spinks might serve as positive role models -- were barred from seeing the fight for financial reasons?

This example illustrates a phenomon which I would call a "two-tiered" culture -- one for those who can pay and one for those who cannot. Such a process is already taking shape in the local sports markets, with regional pay networks "creaming" off the most desired local baseball, hockey and other events. In New York, most of the Mets and Yankee games are on a pay cable service and has started a political controversy. When will this process migrate to national baseball -- the national sport! -- or even the Olympics?

This issue is now being confronted at the local level and only in sports where many municipalities have provided tax breaks and other benefits to sports teams. Over time, it will become an issue taking on national ramifications, with profound ramifications for advertisers as well. It is an issue which will not go away, and should be addressed as a host of cultural products begin to be delivered through electronic means to the household as a transactional service.

David Rosen is Director, Electronic Entertainment, LINK Resources (New York), a consulting firm specializing in the impact of new technologies on the information/entertainment industries. He is also the author of Off-Hollywood: The Making & Marketing of American Specialty Films (Sundance Institute/IFP, 1987; Grove Press, 1989).

